How Activision Ruling Favors M&A Formalities Over Practice

By **John Stigi and Eugene Choi** (March 25, 2024)

John Stigi

Eugene Choi

In Sjunde AP-Fonden v. Activision Blizzard Inc.,[1] the Court of Chancery of the State of Delaware recently declined to dismiss a claim alleging that the board of directors of defendant Activision violated Section 251(b) of the Delaware General Corporation Law, or DGCL, by approving a draft merger agreement between Activision and Microsoft Inc. that was not sufficiently final.

The court held that, notwithstanding market practice, to comply with Section 251(b), the version of a merger agreement the board must consider and approve need not be "execution ready" but must be "essentially complete."

The court also found that to comply with Section 251(c), the notice of the stockholders meeting for approving the merger must contain either a Section 251(b)-compliant version of the merger agreement or a summary thereof.

Practitioners should pay close attention to the court's holdings here as they may vary from what some consider customary market practice.

Facts

The essential facts of the case are straightforward. On Jan. 17, 2022, the Activision board met to approve the merger with Microsoft.

Ahead of that meeting, the board received a draft merger agreement that did not include a company disclosure letter (which was mentioned 45 times in the draft merger agreement but was still being drafted at the time of the board meeting), the disclosure schedules (which were still being negotiated) or the surviving corporation's certificate of incorporation.

The draft merger agreement also had placeholders for the consideration amount and the name of the target. In addition, the terms of the dividend provision, an important issue of how dividends in the post-signing period will be handled, were still being negotiated by an ad hoc committee of the board.

Following the board's approval of the merger agreement, the merger agreement was executed on Jan. 18, 2022. The executed version contained several changes from the draft agreement approved by the board, including the dividend provision.

Activision filed its proxy statement seeking stockholder approval of the merger on March 21, 2022. The proxy statement attached the merger agreement as Annex A, but the attached version did not contain the disclosure letter, disclosure schedules or the surviving corporation's certificate of incorporation.

The notice of the stockholders meeting made reference to this Annex A. The proxy statement contained a summary of the merger agreement, but the notice did not.

The merger agreement was approved and adopted by the Activision stockholders with overwhelming support, and after much antitrust scrutiny, the merger was completed on Oct. 13, 2023.

Holdings

Section 251(b) of the DGCL provides that "the board ... shall adopt a resolution approving an agreement of merger."

The plaintiff stockholder argued that Section 251(b) required the board to approve a version of the draft merger agreement that was "execution ready."

In response, the defendants offered a market practice and practicality argument: Given "the practical realities of negotiating merger agreements, boards commonly adopt resolutions approving a merger agreement in draft or near-final draft form and declaring its advisability before the agreement has been finalized, and this is especially true with respect to ancillary documents, including disclosure schedules."

The court observed that the merger statutes, unlike many parts of the DGCL, are mandatory provisions, and that Delaware courts require strict compliance with statutory requirements governing fundamental transactions such as mergers.

The court concluded that, at a bare minimum, Section 251(b) requires the board to approve an essentially complete version of the merger agreement, and it was reasonably conceivable here that the draft merger agreement approved at the Jan. 17, 2022, board meeting fell short of that standard, as "[t]here was a lot of important stuff missing from the Draft Merger Agreement."

The court took issue with the missing consideration, the missing disclosure containing information that was important to the agreement, the missing surviving corporation's charter that is expressly required by Section 251(b)(4), and the open dividend provision issue.

The court balked at determining at this stage in the litigation whether the disclosure schedules were necessary to comply with Section 251(b), but noted that reasonable minds could reach different conclusions on this point.

The plaintiff also challenged Activision's compliance with Section 251(c) of the DGCL. Section 251(c) provides that the agreement required by Section 251(b) shall be submitted to the stockholders, and the notice of the stockholders meeting for voting on a merger "shall contain a copy of the agreement or a brief summary thereof."

Here, Activision's notice of the stockholders meeting contained a reference to Annex A of the proxy statement, which attached the merger agreement. The court concluded, however, that the attached merger agreement was deficient because it was missing the surviving company's certificate of incorporation.

The defendants then pointed to the summary of the merger agreement in the proxy statement, arguing that Activision complied with Section 251(c) through that summary.

In a technical decision, the court observed that the text of Section 251(c) requires the notice of the stockholders meeting to contain the merger agreement or the summary, and that the proxy statement is not the notice. Accordingly, the court held it was reasonably

conceivable that the plaintiff could state a claim that the defendants did not comply with Section 251(c).

Practitioners will note that Item 601(a)(5) of Regulation S-K in Title 17 of the Code of Federal Regulations, Section 229.601, provides that schedules or similar attachments to exhibits — such as merger agreements — are not required to be filed with the U.S. Securities and Exchange Commission under the federal securities laws, provided that they do not contain information material to an investment or voting decision and that information is not otherwise disclosed in that document.

In particular, it is not customary to include a disclosure letter or disclosure schedules as an annex to Form S-4 or a proxy-prospectus filed with the SEC. We expect the Delaware courts will need to address this interplay in subsequent decisions.

Pushback Against Deference to Market Practice — Calls to Legislature

The ruling in Activision was handed down less than a week after Vice Chancellor J. Travis Laster's decision in West Palm Beach Firefighters Pension Fund v. Moelis & Co.,[2] where the court, to the surprise of many, found that several stockholder agreement provisions were facially invalid under Delaware law because they impermissibly impinged on the board's rights under DGCL Section 141.

A common thread between the two cases is the tension between what sophisticated corporate planners view as market practice and what the Delaware courts interpret to be permissible under the laws of the First State.

Vice Chancellor Laster stated in Moelis, that "market practice is not law. Delaware courts consider market practice, because market practice can reflect the judgments of experienced counsel about what is possible under Delaware law." But, as the opinion also said, "when market practice meets a statute, the statute prevails. Market participants must conform their conduct to legal requirements, not the other way around."

However, both the chancellor and vice chancellor called out to the Delaware Legislature for assistance. In Activision, Kathaleen St. J. McCormick wrote in a footnote that DGCL Section 251 "could be amended to allow a corporation to include the 'brief summary' in the proxy statement," noting that in other contexts, the Delaware Legislature amended the statute in similar ways.

For example, Section 242, which governs amendments to incorporation certificates, was amended in 2014 to eliminate the requirement that the notice of the stockholders meeting contain the amendment or a summary thereof if the notice is a notice of the internet availability of proxy materials under notice and access rules promulgated by the SEC under the Securities Exchange Act.[3]

The chancellor also referenced Section 228 governing stockholder written consents in lieu of meetings, which was amended to permit a notice of internet availability of proxy materials to be provided to stockholders that did not consent.

The vice chancellor in Moelis, also in a footnote, noted that Section 218, the statute authorizing the use of stockholder agreements, "is quite the bare-bones provision. The expansive use of stockholder agreements suggests that greater statutory guidance may be beneficial. ... Its author would welcome additional statutory guidance."

Market practice has evolved in the above two areas where, in the case of DGCL Section 251(c), the statute may not make practical sense, and in the case of DGCL Section 218, the statute is no longer instructive enough to give practitioners the guidance they need for proper corporate planning. We will see if the Delaware General Assembly will respond.

Conclusion

Historically, there has been little guidance from the courts regarding the interpretation of Section 251(b), and market practice influenced what practitioners believed was acceptable under the statute. But as the court noted in Activision, "where market practice exceeds the generous bounds of private ordering afforded by the DGCL, then market practice needs to check itself."

Practitioners should pay careful attention to the completeness of the merger agreement submitted to the board for approval, and make sure the negotiations are settled and that the agreement form is essentially complete, has all essential exhibits attached and contains the items expressly enumerated in Section 251(b).

And, in turn, because practitioners are not likely to change practice and insert a robust merger agreement summary into the notice of the stockholders meeting, the Section 251(b)-compliant merger agreement must be referenced in the notice and presented to the stockholders for approval and adoption.

That is, unless the Delaware General Assembly responds and amends the DGCL.

John P. Stigi is a partner and co-leader of the securities enforcement and litigation team at Sheppard Mullin Richter & Hampton LLP.

Eugene Choi is an associate at the firm.

[1] C.A. No. 2022-1001-KSJM, 2024 WL 863290 (Del. Ch. Feb. 29, 2024, corrected March 19, 2024).

[2] C.A. No. 2023-0309-JTL, -- A.3d --, 2024 WL 747180 (Del. Ch. Feb. 23, 2024).

[3] See 17 C.F.R. § 240.14a-16.